
Will Allocating my Real Estate Value to Enterprise Value Have an Adverse Affect on my REIT Test?

Oftentimes this issue comes up among our Real Estate Investment Trust Clients. The answer is: “it doesn’t have to.” At Paradigm Tax Group, we understand the issues surrounding allocating the different components of value in a Real Estate transaction, and how to allocate in a manner such that you are conforming to the requirements of your REIT test, and at the same time, reaping your full tax savings potential in a fair and equitable manner. How is this done? Transactional taxes and Federal taxes are different matters of different sets of law. As such, we employ different allocations for each in order to conform within their respective definitions. We will explore an example of this later in the article. First, let’s look at the definitions of Transactional Tax and Federal Tax.

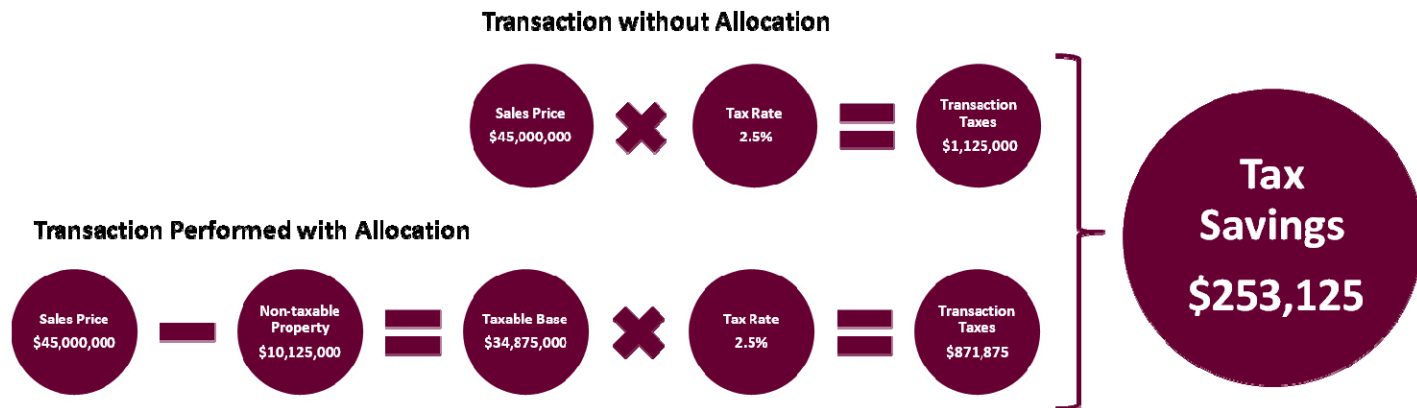
- Transactional Tax is money (tax) that is collected by a locality or state for the transfer of real property or an interest in real property.
- Federal Tax is a tax the federal government levies on businesses and personal income. The federal income tax provides for national programs such as defense, foreign affairs, law enforcement, and interest on the national debt.

Where transactional taxes are imposed on the transfer of real property, allocations of the sales price from real property to intangibles, such as enterprise value or goodwill, would lower the overall cost of transfer. However, 75% of a REIT’s investments must generally be comprised of “Real Property” to qualify as a REIT for federal tax purposes. Paradigm Tax Group strives to record in a “REIT preferred” manner and seeks to manage the collateral damage by securing transfer tax refunds in addition to retroactively proving that intangibles transacted. We have been successful in structuring transactions where the allocation of value for purposes of state and local transactional costs is different than the value allocation for federal income tax purposes. In addition, in an IRS Private Letter Ruling, the IRS concluded that where the value of intangibles, such as goodwill, associated with property is inextricably linked to the real property itself, the intangible also qualifies as “real property” for purposes of the 75% asset test (PLR 200813009, see also PLR 200726002).



Let's look at an example:

A full service hotel was recently purchased by a REIT for \$250,000 per room, when in actuality; the assessments in that particular jurisdiction are \$105,000 per room on average for full service hotels. Here is the difference:



In this example, the company could have saved \$253,125 in taxes.

Paradigm Tax Group has several highly accredited Federal Tax Advisors we work with on a regular basis to oversee the allocation process. Additionally, we work with various firms as requested by our Clients to ensure both parties are completely comfortable with allocations prior to a closing. Furthermore, intangibles can be held in a taxable REIT subsidiary. We've had several clients bifurcate the purchase so that two Purchase and Sale Agreements are made, one for real estate and tangible personal property and another for intangibles.

Upon request and for those interested in learning more about these strategies, Paradigm Tax Group would be pleased to provide contact information for the aforementioned REIT experts to reaffirm the process.

For more information on this topic please contact:

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